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21 November 1973

[Redacted]

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MEMORANDUM FOR: Chief, OCI/WH/SAW

SUBJECT : The Current State of Chile's Economy

[Redacted]

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Attached is the briefing material on Chile as per your request of 14 November 1973. If you have further questions, please contact [Redacted]

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Chief,
South America Branch, OER

Attachment:
As stated

Distribution: (S-5690)
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OER/D/LA [Redacted] (21 Nov 73)

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The Current State of Chile's Economy

- I. Salvador Allende was elected president in 1970 by approximately 36% of the popular vote on a platform of social reform and egalitarian redistribution of income. The vote was divided along class lines with Allende's support coming largely from the poor and militant youth and main opposition from middle class business and professional interests.
- II. The first year of Allende's rule (1971) saw an apparent improvement in the economy.
 - A. Income levels of the poor and workers were raised sharply.
 - B. Rising demand took up the slack in the semi-stagnant economy and GDP grew by 8.4% while unemployment fell.
 - C. Land was expropriated and turned over to the poor.
 - D. Business enterprises, including foreign-owned copper companies, were expropriated. By 1973, more than half of GDP was generated by government-owned business.
- III. Behind the facade of prosperity remained the central fact that Chile was living on its capital and that decapitalization was taking place at a rapid pace. The effects of this policy became evident in 1972.
 - A. Inventory stocks were drawn down and foreign exchange and credit were used to meet rising demand.

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- B. Inefficiencies in the agricultural sector resulting from land redistribution were compensated for by rising imports of agricultural products and food.
 - C. Foreign exchange was drawn down and debts incurred to support the rising level of food and industrial raw material imports.
 - D. Exports declined due to poor management of expropriated firms and the destruction of investor confidence.
 - E. GDP declined by 0.7% in real terms in 1972 compared to an 8.4% increase in 1971.
- IV. Chile's international financial position deteriorated sharply under the Allende regime and its external debt doubled from \$2 billion to ^{nearly} \$4 billion.
- A. In 1971, balance of payment deficits totaled \$305 million compared to surpluses averaging \$145 million annually in the three preceding years.
 - B. In 1972, Chile's total external debt rose by nearly \$910 million, including more than \$200 million of short term suppliers' credits. The balance of payments deficit totaled nearly \$330 million, despite the suspension and rescheduling of more than \$360 million of external debt repayments.

- V. The post-Allende regime's initial economic policies have been directed at stimulating domestic production while returning to an essentially market economy.
- A. The junta devalued the escudo by nearly 60% and reduced the number of exchange rates from six to two. Devaluations are likely to continue until a single exchange rate is achieved sometime next year, a move which should eventually improve Chile's balance of trade and payments.
 - B. The junta has adjusted prices to more closely approximate free market prices. The resulting increases, ranging generally from 200% to 400%, have eliminated the once thriving black market and have brought demand and supply of consumer and producer goods more nearly in line.
 - C. The junta has increased the minimum wage while cancelling a scheduled general wage increase. The minimum wage, if enforced, should ease the burden of the price increases on the lower classes while the freeze on general wages will hold down costs to permit the recovery of production as well as reduce demand.
 - D. The junta increased the work week from 44 to 48 hours. The increase has already stimulated the

recovery of copper production and reportedly is working well in other sectors.

VI. The price increases and wage freezes, however, have reduced real incomes.

A. Chile's cost of living jumped 88% in October, pushing the inflation rate to 150% for the first ten months of the year. Inflation for the year probably will exceed 600%.

B. Despite the price increases, it will take many months for domestic production, especially agriculture, to recover. The immediate consequence has been windfall profits for many merchants.

VII. Unemployment continues to be a serious obstacle to Chile's recovery.

A. Payroll padding under Allende was a major cause of decreased productivity in nearly every sector -- even though it did reduce the level of unemployment.

B. The junta has dismissed large numbers of unproductive government personnel thus increasing unemployment.

VIII. The immediate problems of the junta are complicated by needs for substantial short-term credits and development assistance.

A. Chile needs an estimated \$720 million to meet its external requirements over the next year. It is

believed that this total is now available.

1. Credit lines inherited from Allende amount to about \$350 million.
2. Chile has arranged \$171 million in short-term credits from US and Canadian banks and is negotiating for another \$75 million.
3. Other pending financial assistance includes an estimated \$442 million from Brazil and Argentina, of which \$200 million would be earmarked for capital goods and \$50 million for direct balance of payments relief.

B. The United States has thus far granted \$24 million in CCC credits for wheat purchases and another \$28 million is pending for corn and grain sorghum purchases.

C. Chile's grain needs are urgent due to the deterioration of agriculture under Allende. Food imports in 1973 will be about \$700 million, compared with pre-Allende levels of \$200-\$250 million. Even with some agricultural recovery in 1974, they still will be around \$500 million.

IX. Assistance from International Financial Institutions will depend on Chile's ability to develop a viable economic recovery and stabilization plan.

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- A. Failure to submit such a plan precipitated Allende's loss of credits from international sources.
- B. An IMF team is currently in Chile to evaluate conditions and prospects. The team's report will be issued in January, prior to a meeting of Chile's major creditors to consider the renegotiation of Chile's foreign debts of nearly \$4 billion.
- X. The new government appears ready to meet its obligations emanating from Allende's nationalizations.
 - A. Equitable settlement of outstanding compensation claims will encourage new foreign investment and serve to improve US-Chilean relations.
 - B. The junta will not denationalize the copper properties. However, new investment opportunities on a contract basis may be possible in the future.
- XI. The copper industry, Chile's chief source of foreign exchange, will play a key role in economic recovery and is already showing signs of recovery.
 - A. Although copper production in 1973 is expected to be around 650,000 to 670,000 tons -- down 8% from 1972 -- production in October was more than 52% above the October 1972 level.
 - B. With improved worker discipline and better mine management, copper production in 1974 is expected to reach a record 750,000 tons.

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- D. Capacity in the major mines was expanded by nearly 200,000 tons prior to Allende's nationalizations. Although Allende failed to fully use this new capacity, the junta is expected to significantly increase production in the years ahead.
- E. At present, the major constraints to copper production are shortages of spare parts and such servicable small rolling stock as tractors and service trucks. In some areas less than 40% of critical rolling stock is presently operable.
- F. Despite reports of large scale worker layoffs since the change of government, dismissals in the mining sector have amounted to less than 2.5%. Allende had increased the number of miners by over 25%.

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20 November 1973

Table 1

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Chile: Important Economic Indicators

	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u> <u>Projected</u>
Total net foreign reserves (Millions of US \$)	252.0	343.2	38.8	-289.3	-450 (Sep)
Inflation (Percent variation from December to December)	29.3	34.9	22.1	163.4	300
Exports (Millions of US \$)	1,174.0	1,135.0	984.0	858.0	1,060
Imports (Millions of US \$)					
Customs registrations	917.0	948.0	1,166.0	1,432.0	1,454
Import payments	927.0	1,001.0	1,085.0	1,285.0	--
Payment gap	(10)	(53)	81	147	--
Money supply (Billions of current escudos)	7.7	12.1	25.8	68.0	--
Copper production (Thousands of metric tons)	688.1	685.6	708.3	718.2	670
Large mines	(540.4)	(534.5)	(571.3)	(593.1)	(540)
Small and medium mines	(147.7)	(151.1)	(137.0)	(125.1)	(130)
Iron ore production (millions of metric tons)	11.5	11.3	11.2	9.2	9.0
Unemployment -- greater Santiago (Percentage)	Sept. 5.3	Sept. 6.4	Sept. 4.8	Sept. 3.0	Sept. 4-5
Central government deficit or surplus (as a percent of total central govern- expenditures)	Surplus 1.3	Deficit 11.6	Deficit 33.3	Deficit 60.0	Deficit --
Central government deficit or surplus (as a percent of GDP)	Surplus 0.2	Deficit 0.7	Deficit 9.5	Deficit 22.3	Deficit --
Percentage growth of GDP (In 1965 prices)	3.3	3.1	8.4	-0.7	-5

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Chile: Important Economic Indicators

	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u> <u>Projected</u>
Percentage growth of GDP per capita (In 1965 prices)	0.7	0.6	5.5	-3.2	-7.5
GDP growth by sector					
Manufacturing (Percentage change)	+4.2	1.3	+12.9	+2.5	-10.0
Mining (Percentage change)	+4.0	1.0	1.7	-0.8	-9.0
Agriculture (Crop year)	68/69 -4.0	69/70 +5.0	70/71 +5.1	71/72 -16.0	72/73 -14.0

Table 2

Summary Balance of Payments (IMF format)

	<u>1970</u>	<u>1971</u>	<u>1972</u>
1. Exports	1135	984	858
2. Imports (Registrations)	-948	-1166	-1432
3. <u>Trade Balance</u>	<u>187</u>	<u>-182</u>	<u>-574</u>
4. Investment Income	-164	-137	-106
5. Other services	-39	2	-27
6. <u>Current Account Balance</u>	<u>-16</u>	<u>-317</u>	<u>-707</u>
7. Private Capital	12	-113	-52
8. Public Sector	191	-10	-184
9. <u>Capital Account Balance</u>	<u>203</u>	<u>-123</u>	<u>-236</u>
10.. Errors and omissions	-64	-17	35
11. <u>Total Deficit (6+9+10)</u>	<u>+123</u>	<u>-457</u>	<u>-908</u>
12. SDR Allocation	21	17	18
13. <u>Debt Relief</u>	----	54	361
14. Growth in Floating Debt to Suppliers	-53	81	201
15. <u>Reserve Movements</u>	<u>-91</u>	<u>305</u>	<u>328</u>

Reserve Assets and Liabilities of the Banking System

	Million US \$				
	Dec 1970	Dec 1971	Dec 1972	Mar 1973	Sep 1973*
Total Disposable Assets:	439.4	252.6	203.7	166.3	130
Of which ...					
-Central Bank	(378.8)	(213.5)	(150.4)	(106.7)	(70)
-Commercial Banks	(60.6)	(39.1)	(53.3)	(59.6)	(60)
Non-Liquid Assets	16.7	7.6	1.4	22.4	20
Liabilities:	112.9	222.0	494.4	548.2	600
Of which ...					
-Central Bank	(62.8)	(128.6)	(261.3)	(297.5)	(-)
-Commercial Banks	(50.1)	(93.4)	(233.1)	(250.7)	(-)
Net Reserves:	343.2	38.2	289.3	359.5	450
*Estimated					